

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 387

May 5, 1975

CONTINGENT BENEFICIARY: TAX ON PREFERENCE INCOME

Syllabus:

An out of state trust with a nonresident fiduciary distributed accumulated capital gain of \$1,200,000 to a resident contingent beneficiary.

Question:

What amount of the distribution is to be considered by the beneficiary for purposes of the tax on preference income in the following situations:

- (1) if the distribution was in 1971;
- (2) if the distribution was in 1973;
- (3) if the contingent beneficiary became a resident in June, 1972 and the distribution was in 1973;
- (4) if part of the capital gain distributed by the trust was from sales made in 1971.

Discussion:

§ 17064.5(f)(3) states:

Except as otherwise expressly provided in this chapter, the term "taxes" includes the minimum tax imposed by this chapter.

Concerning a contingent beneficiary's tax liability upon receipt of a trust distribution, § 17745 provides in part:

- (b) If no taxes have been paid on the current or accumulated income of the trust because the resident beneficiary's interest in the trust was contingent such income shall be taxable to the beneficiary when distributed or distributable to him.
- (c) The tax on such income which is taxable to the beneficiary under subdivisions (a) or (b) is a tax on the receipt of such income distributed or on the constructive receipt of such distributable income. For purposes of this section income accumulated by a trust continues to be income

even though the trust provides that the income (ordinary or capital) shall become a part of the corpus.

(d) The tax attributable to the inclusion of such income in the gross income of such beneficiary for the year such income is distributed or distributable under subdivision (b) shall be the aggregate of the taxes which would have been attributable to such income had it been included in the gross income of such beneficiary ratably for the year of distribution and the five preceding taxable years, or for the period that the trust accumulated or acquired income for such contingent beneficiary, whichever period is the shorter.

(1) Ratably including the \$1,200,000 in the contingent beneficiary's gross income in the year of distribution, 1971, and the five preceding years, allows for an inclusion of \$200,000 in each year.

As the tax on preference income became effective in 1971, the excludable portion of capital gain for that year (\$100,000), is the only amount subject to preference tax consideration.

(2) If the distribution had occurred in 1973, the ratable inclusion in gross income of the \$1,200,000 would be \$200,000 for that year and the five preceding years.

As the tax on preference income was initiated in 1971, the excludable portion of capital gain (\$100,000) attributable to 1971, 1972 and 1973, respectively, is subject to the tax on preference income.

Therefore, the amount of tax due in 1973 is the aggregate of the taxes relative to the preference income that has been ratably attributed to the beneficiary for the years 1971, 1972 and 1973.

(3) If the taxpayer became a resident in June, 1972 and the distribution was in 1973, § 17745 again provides for the inclusion, on a ratable basis, of the \$1,200,000 in the beneficiary's gross income for 1973 and the five preceding years.

Upon establishment of residency in 1972 and its continuation through 1973, the excludable gain ascribed to each of these years (\$100,000 respectively) is the amount considered as the beneficiary's preference income.

§ 17745 does not provide for proration of the amount attributable to the year California residency was established.

Accordingly, the tax due on preference income in 1973 is the aggregate of the taxes imposed on that part of the distribution pertaining to the years 1972 and 1973.

(4) The sale of capital assets by an out of state trust in 1971 with distribution in the same year should not affect the conclusion as heretofore presented in part one (1).

A contingent beneficiary is taxed upon receipt of the trust distribution. § 17745 (d) provides the direction for the amount of tax resulting from such distribution without regard to or differentiation of the trust's actual dates of sale.